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THE RATE OF INTEREST.

In the course of his incisive reply to Professor Macvane's remarkable rehabilitation of the wages-fund theory, Mr. Walker incidentally makes some noteworthy admissions as to the nature of the "interest" which forms a part of business profit.

1. It appears that Mr. Walker's "interest" is not any of the kinds of interest known to the practical man or to the classic economist. It is (p. 286, note) neither "the current rate paid on loans in the money market" nor "the current rate paid on more permanent loans on security," nor even "the normal rate to which the variations in current rates of loan interest tend to conform." But it is clearly the last named, which, as Mr. Walker said in his April article, "all economists, from Adam Smith down," have had in view as a constituent of profits, and to which Professor Marshall refers as the "rate of interest." It is this interest which is supposed to tend to equality and to decline. And I entirely agree with what I understand his meaning now to be,—that this old "normal rate of loan interest" does not, with rent, wages, and the "rent of ability," complete the distribution of the product. I attempted, in the January number of this journal, to show that the interest which entered into profits was something more than this; and I gather that Mr. Walker so far agrees with me. It would be interesting (if Mr. Walker does not accept the "law of economic interest" therein stated) to know more particularly what relation he conceives this interest to bear to "normal loan interest" and how its amount is determined.

2. Mr. Walker may reply that he has dealt with this point in stating (pp. 285–287) that the rate of interest is determined by the "final utility" of capital; that is to say, by the return to be obtained by the use of the last increment of capital employed. But this is obviously the law expressing the interest to be obtained on loans upon security; and that Mr. Walker had this "loan interest" in view is evident from his summing up the argument (pp. 286, 287) by saying that, "notwithstand-

ing that the utility of the successive increments of capital applied to production has varied within a wide range, all the loans made would, in a money market where perfect competition existed, be made at the same rate,—the rate, namely, which the last borrower can afford to pay.” This still leaves us without any determination of the amount of the interest which enters into profit (“economic interest”), which, in the note on the same page, Mr. Walker admits to be something different from “loan interest,” whether market or normal. Who gets the advantage of the higher utility of the increments of capital applied at greater advantage than that of the last increment? It will hardly be asserted that this is (even in perfectly free competition) immediately and wholly ceded to the consumer, as values will continue to depend on the cost of production of the portion of the supply produced under the most disadvantageous circumstances (*i.e.*, with the final increment of capital). What is the cause of the high market value of the “good will” of a business?

3. But, notwithstanding his virtual admission that the successive increments of capital are applied with diminishing advantage, Mr. Walker refuses to admit that the “return to capital” varies. “All portions of capital do, in proper economic theory, bear an equal rate of interest” (p. 287). Is he not still thinking only of loan interest? If there is a difference in the amount of product turned out by two undertakings, and this difference is caused neither by difference in the land used nor in the amount of labor employed, nor in the ability or skill of the labor or of the management, it may fairly be ascribed to the varying advantages of the capitals employed, as it passes with their ownership, and is included in their price. It is true that in such a case the market value of the two undertakings (that is, the nominal valuation of their capitals) will be strictly in proportion to the net incomes yielded by them. But this fact (which is equally true of lands of different fertilities) does not, of course, mean that the returns to the capitals invested bear an equal proportion to those capitals. Industrial capital does not consist of valuations, in currency, of opportunities of profit. Cotton is not spun by share quotations, but by actual machines of wood and

iron, which function with more or less efficiency, quite irrespective of the price of cotton-mill shares.

4. The fact is that Mr. Walker exaggerates the possible mobility of capital. He fully recognizes that, even in perfect omniscient competition, the industrial capabilities of lands and abilities will continue to vary. Equally, the industrial advantages of railways, ships, houses, harbors, docks, water-works, gas-works, tramways, quarries, mines, canals, markets, fishings, and countless other durable forms of so-called fixed capital, must necessarily vary. It will hardly be denied that the return from these instruments will be according to the law of rent, and these (with land) make up three-fourths in value of the whole realized wealth of the United Kingdom. But, in every department of industry, the means of production, contemporaneously employed, vary in efficiency. The Cornish mines still use beam-engines dating from Newcomen. Sailing ships still plough the ocean alongside of quadruple expansion engines. The flail is worked in Germany as well as the threshing machine. Boots are still made by hand in competition with steam boot factories. The van of industrial progress must always be in advance of the stragglers (irrespective of patents or monopolies), if only while the old appliances are wearing out. And, since it is the article produced under the most disadvantageous circumstances which determines the value of the whole, there must necessarily be a real "rent" upon all but the capital employed under those worst circumstances. This (with the constantly existing cases of rent of opportunity) is obviously the source of the large industrial profits. Any successful manufacturer would scoff at the notion of his profits having been merely five per cent. plus his salary as manager.

5. What is mobile is "loan capital." As Bagehot vividly described, this flows unceasingly where it can be most productive; and its law is undoubtedly "equality of returns." Its influence, moreover, is a perpetually levelling one, its re-enforcement of the capital of superior efficiency constantly eliminating the industrial capital embodied in obsolescent forms of inferior efficiency. But the process is never ending; and there can be conceived no moment in which every application of

labor, throughout all trades all over the industrial community, will be aided to exactly the same degree by capital of precisely equal efficiency. The hypothetical equilibrium is dynamic and not static, a "becoming" and not a "being." Therefore, in pure economic theory, as in actual fact, there is normally a real rent of capital; and it is this (economic interest) which enters (with rent of ability) into business profits, and not merely "loan interest" (as, indeed, Mr. Walker recognizes).

6. Whether anything is gained by describing the aggregate of this varying economic interest as a rate per cent. on the aggregate nominal value of the capitals employed is open to question, since the exchange value of each portion of capital itself depends on the amount of income to be derived from its use, in comparison with current loan interest and the risk, social estimation, and other attributes of the undertaking. We do not, in economics, speak of land rent as a percentage of the value of land; and the market value of the industrial capital in any commercial undertaking is determined on principles precisely similar to those governing the price of real estate, and equally without the slightest reference to its original cost to the proprietor.

It is therefore submitted that the scope of the Ricardian law of rent must (as Whately long ago suggested) be extended even further than Mr. Walker would carry it,—extended, indeed, from agricultural land to all the instruments of production, as well as to the varying efficiencies of every kind of human labor. In this sense, the whole product is divided between rent and wages; between what can be produced by the average workman at the margin of cultivation, without skill or capital, and what is actually produced in each case throughout the industrial community by the aid of land, instruments, and skill of varying superior efficiency. The loan interest received by a mere investing capitalist is but a part of the excess product caused by the use of that capital, the balance of "economic interest" being retained by the capitalist *entrepreneur*.

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